

Municipal Secondary Market Disclosure Information Cover Sheet

This cover sheet should be sent with all submissions made to the Municipal Securities Rulemaking Board, Nationally Recognized Municipal Securities Information Repositories, and any applicable State Information Depository, whether the filing is voluntary or made pursuant to Securities and Exchange Commission rule 15c2-12 or any analogous state statute.

See www.sec.gov/info/municipal/nrmsir.htm for list of current NRMSIRs and SIDs

IF THIS FILING RELATES TO A SINGLE BOND ISSUE:

Provide name of bond issue exactly as it appears on the cover of the Official Statement (please include name of state where issuer is located):

Provide nine-digit CUSIP* numbers if available, to which the information relates:

IF THIS FILING RELATES TO ALL SECURITIES ISSUED BY THE ISSUER OR ALL SECURITIES OF A SPECIFIC CREDIT OR ISSUED UNDER A SINGLE INDENTURE:

Issuer's Name (please include name of state where Issuer is located):

PUBLIC FACILITIES FINANCING AUTHORITY OF THE CITY OF SAN DIEGO, CALIFORNIA

Other Obligated Person's Name (if any):

THE CITY OF SAN DIEGO, CALIFORNIA – THE ULTIMATE CREDIT BEING THE SEWER REVENUE FUND OF THE CITY OF SAN DIEGO

Provide six-digit CUSIP* number(s), if available, of Issuer: **79730A**

*(Contact CUSIP's Municipal Disclosure Assistance Line at 212.438.6518 for assistance with obtaining the proper CUSIP numbers.)

TYPE OF FILING:

☐ Electronic (Number of pages attached)

☒ Paper (Number of pages attached): 18

If information is also available on the Internet, give URL:

WHAT TYPE OF INFORMATION ARE YOU PROVIDING? (Check all that apply)

A. ☐ Annual Financial Information and Operating Data pursuant to Rule 15c2-12

(Financial information and operating data should not be filed with the MSRB.)

B. ☐ Audited Financial Statements or CAFR pursuant to Rule 15c2-12

C. ☐ Notice of a Material Event pursuant to Rule 15c2-12 (Check as appropriate)

- | | |
|--|--|
| 1. <input type="checkbox"/> Principal and interest payment delinquencies | 6. <input type="checkbox"/> Adverse tax opinions or events affecting the tax-exempt status of the security |
| 2. <input type="checkbox"/> Non-payment related defaults | 7. <input type="checkbox"/> Modifications to the rights of security holders |
| 3. <input type="checkbox"/> Unscheduled draws on debt service reserves reflecting financial difficulties | 8. <input type="checkbox"/> Bond calls |
| 4. <input type="checkbox"/> Unscheduled draws on credit enhancements reflecting financial difficulties | 9. <input type="checkbox"/> Defeasances |
| 5. <input type="checkbox"/> Substitution of credit or liquidity providers, or their failure to perform | 10. <input type="checkbox"/> Release, substitution, or sale of property securing repayment of the securities |
| | 11. <input type="checkbox"/> Rating changes |

D. ☐ Notice of Failure to Provide Annual Financial Information as Required

E. ☒ Other Secondary Market Information (Specify): **Voluntary Report of Information relating to the obligations of the City with respect to the San Diego City Employees Retirement System and certain errors to the financial statements of the Metropolitan Wastewater Utility as of June 30, 2002 and 2001.**

I hereby represent that I am authorized by the issuer or obligor or its agent to distribute this information publicly:

Issuer Contact:

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Employer: **CITY OF SAN DIEGO**

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Title: **DIRECTOR OF PUBLIC AND MEDIA AFFAIRS**

Telephone: **(619) 236-6851**

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**VOLUNTARY REPORT OF INFORMATION
DATED JANUARY 27, 2004**

RELATING TO

\$315,410,000
Public Facilities Financing Authority
of the City of San Diego
Sewer Revenue Bonds, Series 1999A and Series 1999B
(Payable Solely From Installment Payments Secured
By Wastewater System Net Revenues)
(CUSIP Number 79730A)

\$250,000,000
Public Facilities Financing Authority
of the City of San Diego
Sewer Revenue Bonds, Series 1997A and 1997B
(Payable Solely From Installment Payments Secured
By Wastewater System Net Revenues)
(CUSIP Number 79730A)

\$350,000,000
Public Facilities Financing Authority
of the City of San Diego
Sewer Revenue Bonds, Series 1995
(CUSIP Number 79730A)

\$250,000,000
Public Facilities Financing Authority
of the City of San Diego
Sewer Revenue Bonds, Series 1993
(CUSIP Number 79730A)

The City of San Diego, California (the “City”) is submitting this Voluntary Report of Information (this “Report”) to the Municipal Securities Rulemaking Board (“MSRB”) and the Nationally Recognized Municipal Securities Information Repositories (“NRMSIRs”). See Exhibit A for the listing of NRMSIRs. The City is submitting this Report on behalf of itself and on behalf of the Public Facilities Financing Authority of the City of San Diego (the “Authority”) for the above-mentioned issuances. The City may or may not from time to time voluntarily submit additional information. This submission does not constitute a commitment to provide information beyond the disclosure requirements of any applicable Continuing Disclosure Agreements related to any of the above-mentioned issuances (collectively, the “Continuing Disclosure Agreements”).

This Report is dated as of January 27, 2004 (the “Dated Date”) and speaks only as of the Dated Date. Readers are cautioned not to assume that any information has been updated beyond the Dated Date unless this Report expressly states that it constitutes an update of a specific matter in a document. The City expressly disclaims any duty of the City or the Authority to provide an update of this Report or a further update of any document, or matter therein, specifically referenced.

The filing of this Report does not constitute or imply any representation (1) that any or all of the information provided is material to investors, (2) regarding any other financial, operating or other information about the City or the Authority, or the above stated issuances, (3) that no changes, circumstances or events have occurred which may have a bearing on the security for the above-mentioned issuances or an investor’s decision to buy, sell or hold the above-mentioned issuances.

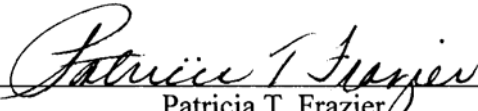
Certain statements contained in this Report reflect not historical facts but forecasts and “forward-looking” statements. In this respect, the words “estimate,” “project,” “anticipate,” “expect,” “intend,” “believe” and similar expressions are intended to identify forward-looking statements. Projections, forecasts, assumptions, expressions of opinions,

estimates and other forward-looking statements, are not to be construed as representations of fact and are qualified in their entirety by the cautionary statements set forth in this Report.

Any statements regarding the above-mentioned issuances, other than a statement made by the City in an official release or subsequent notice or annual report, published in a financial newspaper of general circulation and/or filed with the MSRB or the NRMSIRs, are not authorized by the City or the Authority. Neither the City nor the Authority shall not be responsible for the accuracy, completeness or fairness of any such unauthorized statement.

DATED: January 27, 2004

CITY OF SAN DIEGO



Patricia T. Frazier
Deputy City Manager

EXHIBIT A

Nationally Recognized Municipal Securities Information Repositories approved by the Securities and Exchange Commission.

Bloomberg Municipal Repository

100 Business Park Drive
Skillman, NJ 08558
Email: Munis@Bloomberg.com
Phone: (609) 279-3225
FAX: (609) 279-5962

FT Interactive Data

Attn: NRMSIR
100 William Street
New York, NY 10038
Email: NRMSIR@FTID.com
Phone: (212) 771-6999
FAX: (212) 771-7390

Standard & Poor's J. J. Kenny Repository

55 Water Street, 45th Floor
New York, NY 10041
Email: nrmsir_repository@sandp.com
Phone: (212) 438-4595
FAX: (212) 438-3975

DPC Data, Inc.

One Executive Drive
Fort Lee, NJ 07024
Email: nrmsir@dpcdata.com
Phone: (201) 346-0701
FAX: (201) 947-0107

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VOLUNTARY REPORT OF INFORMATION
DATED JANUARY 27, 2004

This Voluntary Report of Information (this “Report”) is being provided by the City of San Diego (the “City”) on behalf of itself and on behalf of the Public Facilities Financing Authority (the “Authority”) for the above-mentioned issuances. This Report consists of two parts. First, Part I of this Report provides information regarding the obligations of the City’s Sewer Revenue Fund to make payments to the San Diego City Employees Retirement System (“SDCERS”). Part I supercedes all disclosure made by the City with respect to the Sewer Revenue Fund’s obligations to make payments to SDCERS pursuant to Securities and Exchange Commission Rule 15c2-12 or otherwise, including information under the heading “PENSION PLAN” contained in the Annual Report as of June 30, 2002. Second, Part II of this Report provides information regarding certain errors made in the financial statements of the Metropolitan Wastewater Utility as of June 30, 2002 and 2001.

PART I

PENSION PLAN

City Employees' Retirement System

All benefited City employees participate with the full-time employees of the Airport Authority (the "Airport Authority") and the San Diego Unified Port District (the "District") in the City Employees' Retirement System ("CERS"). CERS is a public employee retirement system that acts as a common investment and administrative agent for the City, the Airport Authority and the District and is governed by a board of trustees (the "Board"), the membership of which is composed as follows: three members are elected by the general members (who are active employees of the City other than police, fire and other safety members), one member is elected by active fire employees of the City, one member is elected by active police employees of the City, one member is elected by retirees who are members of CERS, three members are ex-officio members (who are a designee of the City Manager, a designee of the City Auditor, and the City Treasurer), and four members who are appointed by the City Council. Through various City benefit plans, CERS provides retirement benefits to all general, safety (police and fire), and legislative members. The information set forth herein relates solely to the City's, including the Wastewater System's, participation in CERS and not to the Airport Authority or the District.

The CERS plans are structured as defined benefit plans in which benefits are based on salary, length of service, and age. City employees are required to contribute a percentage of their annual salary to CERS. The obligation to make contributions to CERS is based on the San Diego City Charter and the San Diego Municipal Code and, to the extent that available CERS assets are less than vested benefits, is an obligation imposed by law upon the City.

According to the preliminary Annual Actuarial Valuation of CERS dated as of December 18, 2003 (the "Preliminary Valuation"), the funded ratio (valuation of assets available for benefits to total actuarial accrued liability) of the CERS fund as of June 30, 2003 was 67.2%, which is the lowest funded ratio as of the end of any of the fiscal years ended June 30, 1996 through 2003. According to the Preliminary Valuation, the CERS fund had an unfunded actuarial accrued liability (the "UAAL") of \$1.157 billion as of June 30, 2003, which represented a \$437 million increase in the UAAL over the previous actuarial calculation as of June 30, 2002. The UAAL is the difference between total actuarially accrued liabilities of \$3.533 billion and actuarially calculated assets allocated to funding of \$2.375 billion. The estimated portion of the UAAL attributable to employees payable from the Wastewater System was approximately \$63.6 million as of June 30, 2003, which is calculated based on a 5.5% pro rata share attributable to the Wastewater System and is derived from a three -year average of the Wastewater System's portion of total employer contribution amounts for fiscal years 2000, 2001, and 2002. The increase in the UAAL as of June 30, 2003 resulted primarily from lower actual investment returns as compared to the 8% actuarially assumed rate of return on investments. The Preliminary Valuation has neither been finalized by the CERS actuary nor approved by the Board, and the final annual actuarial valuation of CERS for the year ended June 30, 2003 will not be completed until the first calendar quarter of 2004. Accordingly, the results presented in the Preliminary Valuation are subject to change.

Currently, the UAAL is being amortized over a 30-year period, which started July 1, 1991, with each year's amortization payment reflected as a portion of the percentage of payroll representing the employer's contribution rate. As of June 30, 2003, there were 18 years remaining in the amortization period. (The Board can change the amortization period at any time and from time to time.) However, while the UAAL is currently being amortized over a fixed 30-period ending June 30, 2021, for purposes of financial reporting by the City, a Net Pension Obligation ("NPO") has been calculated using a rolling forty-year period and not over the remaining portion of the fixed thirty-year period. See **"Part II — 2002 Financial Statement Errors"** in the third paragraph, Item 3.a. for a discussion regarding the amortization of the City's actuarially required contribution on the basis of a running forty-year amortization rather than a thirty-year fixed amortization beginning July 1, 1991.

Wastewater System Funding Status. Between June 1996 through June 30, 2002, the City made annual contributions to CERS in accordance with a funding method which, under two successive arrangements with CERS (the "1996 Arrangement" and the "2002 Agreement"), permitted contributions to be made by the City to CERS at specified rates (the "Corridor Method of Funding"). These specified rates were below the rates of more conventional pension plan funding methods, which calculate annual contributions in accordance with the rates determined by a reporting actuary, which in the case of the City, utilized a fixed 30-year amortization period which began on June 30, 1991 (the "Actuary Method"). During fiscal years 1997 through 2002, the Wastewater System also made contributions in accordance with the Corridor Method of Funding. During those years, the aggregate difference in the amounts that the Wastewater System paid to CERS in accordance with the Corridor Method of Funding and the amounts that the Wastewater System would have paid to CERS if it had paid in accordance with the Actuary Method was approximately \$3.7 million (the "Additional Amount").

Between the fiscal years ended June 30, 1997 and 2003, a number of events occurred which impacted the UAAL: Investment results of CERS below the actuarially assumed rate of 8% per annum occurred as a consequence of declines in the securities market; the City, like other local agencies in California, in settlement of litigation (the "Corbett Settlement")^{*} seeking to calculate compensation for benefits over a greater amount than just direct pay, agreed to increase benefits which in turn increased actuarially determined liabilities; demographic changes; the City's contributions to CERS of approximately \$80.2 million less than the City would have contributed if it had contributed at the actuarially determined rates as of June 30, 2003 (utilizing a 30-year fixed amortization period ending June 30, 2021); increases in CERS reserves, as well as other events to a lesser degree. During the same period, the funded ratio declined from 93.3% to 67.2%.

Under the 1996 Arrangement, if the funded ratio fell below 82.3% the City's contributions to CERS would increase. It is the view of the City that such increased payments

^{*} With regard to retired employees covered by the Corbett Settlement (approximately 4,000 in number), the settlement provided for a flat increase of 7% in benefits, payable from net earnings and gains in CERS, after deducting amounts for expenses, certain benefits and certain reserves (the "Corbett Contingency"). The last Corbett Contingency was paid in November 2001. To the extent not paid by CERS, the unpaid amount is carried forward until there are available net earnings, but no interest is accrued thereon. The Corbett Contingency is not reflected in the UAAL or the City's contractually or actuarially determined contribution rates. As of June 30, 2003, the cumulative unpaid Corbett Contingency approximately was \$10.8 million.

needed to be only up to the actuarially determined contribution rate. Under the view of certain Board members and others, the City was obliged to fund up the difference over one or a small number of annual periods without regard to actuarially determined contribution rates. The 2002 Agreement made clear that the City's duty is to make such increases in payments such that, for the fiscal year ended June 30, 2009, contributions are being made at actuarially determined rates.

Starting with fiscal year 2003, the Wastewater System ceased making its annual contributions to CERS in accordance with the Corridor Funding Method, and began to make its annual contributions to CERS in accordance with the Actuary Method. The Wastewater System anticipates that for fiscal year 2004 and for the foreseeable future, the Wastewater System will make annual contributions to CERS in accordance with the Actuary Method. In addition, on June 30, 2003, the Wastewater System paid \$3.0 million in addition to the amounts that the Wastewater System paid pursuant to the Actuary Method for fiscal year 2003. This amount represented the Wastewater System's share of the estimated Net Pension Obligation as of June 30, 2002, which is an amount that is presented on the Metropolitan Wastewater Utility financial statements and, like other amounts presented on those financial statements, was calculated on the basis of amortizing the UAAL over a rolling forty-year amortization period (as opposed to the 30-year fixed period that the annual actuary valuation uses). The Wastewater System paid these additional amounts to CERS to reduce the Additional Amount for fiscal years 1997 through 2002, to \$726,000.

Based upon estimates prepared for the City, assuming no newly created pension benefit increases or decreases between now and fiscal year 2011, the City anticipates (1) that the annual contributions of the City (including the general fund and the Wastewater System) will continue to rise, (2) that the funded ratio may drop to as low as 65%, and (3) that the UAAL may rise to as high as \$2.4 billion. In addition, this does not take into account contingent or supplemental payments from CERS and the portions of employee contributions (which are referred to as "offsets") that the City may be required to pay pursuant to labor arrangements. While these issues may adversely impact the City's general fund, the City does not believe that these issues will be materially adverse to the Wastewater System. Moreover, it should be noted that in the Installment Purchase Agreement, the City has covenanted to fix, prescribe and collect rates and charges for the wastewater service that will be at least sufficient to pay during each fiscal year all Obligations payable in such fiscal year, and to yield during each fiscal year Net System Revenues equal to 120% of the debt service on Parity Obligations for such fiscal year.

Pending Litigation Challenging the City's Funding Arrangements. As indicated below under "**Litigation Relating to the Retirement System**", the plaintiffs in pending litigation have alleged that neither the 1996 Arrangement nor the 2002 Agreement provided for permissible levels of contributions to CERS required by the City Charter or the Municipal Code, each of which, it is alleged, would require larger contributions by the City. The City does not believe that an adverse decision in such litigation will be materially adverse to the Wastewater System.

Post-Retirement Healthcare Benefits. As indicated in Note 7 of Notes to the Financial Statements of the Metropolitan Wastewater Utility as of June 30, 2002 and 2001 (the "Financial Statements"), the City, including the Wastewater System, provides healthcare benefits/premiums to a variety of retired employees. Currently, the benefits are primarily for employees who were actively employed and retired on or after October 1980 and were otherwise entitled to retirement

allowances. Most eligible employees are entitled to receive health insurance premiums up to a cap established in 2002 and based upon other healthcare programs/ premiums sponsored by the City (including the Wastewater System), and adjusted annually based upon the projected increase for national health expenditures by the centers for Medicare and Medicaid Services. Employees who retired or terminated prior to October 1980 who were eligible for retirement allowances prior to that date are also eligible for healthcare benefits (currently approximately 750 employees) but their healthcare benefits are limited to a total of \$1,200 per year.

Since 1995, amounts have been transferred to CERS Basic Assets from net earnings on the Basic Assets in CERS, *i.e.*, dividends, interest and net realized gains from the sale of securities, and an equivalent amount is paid by the City into a CERS reserve for post-retirement healthcare benefits (the "Insurance Benefit Account"). It is from this Account that post-retirement/healthcare premiums/benefits are paid. Accordingly, the statement in Note 7 of Notes to the Financial Statements regarding recognized expenditures refers to expenditures from the Insurance Benefit Account of CERS, not the Wastewater System or any other resources of the City. There have been no payments by the City into the Insurance Benefit Account of CERS since the year ended June 30, 2003.

For the year ended June 30, 2003, approximately \$11,450,200 was charged against the Insurance Benefit Account for health benefits and insurance premiums payments, and the remaining balance in the account at that date was \$20,740,269. For the fiscal year ending June 30, 2004, the amount of \$13 million is projected for healthcare benefits. Neither CERS nor the City tracks the departments or funds from which retired personnel receiving health benefits or premium payments, when in active service, were paid.

The City projects that if there are no further contributions to the Insurance Benefit Account, such Account will be exhausted during the fiscal year ending June 30, 2005, whereupon the City will be required to make direct payments. (Subject to approval of the City Council, it is anticipated that another \$25 million will be transferred from Basic Assets to the Insurance Benefit Account, which, it is estimated, will extend through June 30, 2006 the payment by CERS of healthcare benefits/premiums for eligible retired employees.) If the Insurance Benefit Account of CERS becomes exhausted, the Wastewater System may have to incur additional annual expenses related to post-retirement healthcare benefits.

In a report to the City Council Committee on Rules, Finance and Intergovernment Relations rendered February 5, 2003, the Administrator of CERS reported that based on very general estimates, and not on an actuarial analysis, the present value of the liability for such benefits for current active employees and existing retirees in the retirement plan was in the neighborhood of an amount of which could be between \$600 million and \$1.1 billion (or \$33 million to \$61 million for the Wastewater System, which is calculated based on a 5.5% pro rata share attributable to the Wastewater System and is derived from a three-year average of the Wastewater System's portion of total employer contribution amounts for fiscal years 2000, 2001, and 2002); and, unless included in an actuarially computed contribution or unless earnings from CERS were sufficient to create ongoing excess earnings, any future responsibility of the City would have to be funded from other sources. The Administrator's report indicates that the current method will almost certainly require a change in the benefits or funding from sources other than CERS and its reserves in the not too distant future.

Currently, there is no accounting rule that requires governmental agencies, such as the City, to account for post-retirement healthcare benefits as it accounts for vested pension benefits. A recent exposure draft by the Governmental Accounting Standards Board, which would have required such accounting, is being revised and is expected that a new such exposure draft will be published sometime in the calendar year 2004, and may be formally considered as early as July, 2004.

City and Other Actions. The City is evaluating the fiscal status of CERS to determine the best course of action to improve funding status of CERS as regards pension benefits and availability of surplus funds in CERS to pay post-retirement healthcare premiums/benefit payments. To this end, the Mayor and the City Council have recently formed a pension reform committee to study, and provide recommendations to address, any unfunded liability problems of CERS. The committee will also review and consider the scope and depth of certain audits that have been commissioned by the Board (including audits of the actuarial process and the investment operations) and provide input to the Board's Audit Committee. The Committee will also examine how CERS has performed compared to other systems, including actions other systems have taken to address funding shortfalls. The group will also analyze the representative constitution of the Board and consider whether it should be restructured. It is expected to make an interim report to the City Council no later than February 2004.

Litigation Relating to the Retirement System

General. In January 2003, a putative class action complaint (*Gleason v. San Diego City Employees' Retirement System, et al.*) was filed in the San Diego Superior Court against the City and CERS. A class has not yet been certified. The complaint alleges that from the fiscal year ended June 30, 1997 to the present, the City has not contributed to CERS the annual amount required by certain provisions of the San Diego City Charter and the San Diego Municipal Code. Instead, the plaintiffs allege that the City has been contributing an annual amount to CERS that is based on the 1996 Arrangement and the 2002 Agreement. Plaintiffs further allege that as a result of these violations, and the breaches of duty of the Board, as of the date the complaint was filed, CERS was less than 68% funded and the UAAL was \$720 million. (According to the CERS annual actuarial valuation, the funded ratio as of June 30, 2002 was 77.3%.) As to the City, the plaintiffs seek (a) a judicial declaration that the City has violated the City Charter and Municipal Code provisions, and (b) a judicial declaration as to the appropriate remedies for the City's alleged violation of the City Charter and the Municipal Code.

The plaintiffs allege that the City is obligated to make additional contributions to CERS on two bases. First, the plaintiffs allege that the City has failed to comply with a provision of the City Charter that requires the City to contribute to CERS an amount substantially equal to the amounts that employees contribute to CERS. The plaintiffs allege that the difference between the amount of total employee contributions between fiscal years 1997 and 2002 and the amount of contributions by the City during the same period were not substantially equal. The amount of the difference alleged by the plaintiffs which the City believes is attributable to employees of the Wastewater System is approximately \$2.1 million, which is calculated based on a 5.5% pro rata share attributable to the Wastewater System and is derived from a three-year average of the Wastewater System's portion of total employer contribution amounts for fiscal years 2000, 2001,

and 2002. The City disputes the plaintiffs' calculations and maintains that the amount of its contributions between fiscal years 1997 and 2002 is substantially equal to the amount of employee contributions during the same period. Second, the plaintiffs allege that the City Charter and the Municipal Code require the City to contribute to CERS in respect to members a percentage of earnable compensation as determined by the CERS's actuary pursuant to the annual actuarial valuation. In a separate lawsuit (*Gleason v. San Diego City Employees' Retirement System*), the plaintiff is attempting to invalidate the 2002 Agreement between the City and CERS based on certain conflict of interest allegations. The City contends that its contracts with CERS are lawful and binding contracts.

Impact on the Wastewater System. As discussed above under “**City Employees' Retirement System — Wastewater System's Funding Status**” in more detail, the Wastewater System has made its annual contributions to CERS in accordance with the Actuary Method since fiscal year 2003. As discussed above under “**City Employees' Retirement System — Wastewater System's Funding Status.**” On June 30, 2003, the Wastewater System made certain payments, which reduced the Additional Amount to \$726,000. The City anticipates that the Wastewater System will continue to pay amounts to CERS in accordance with the Actuary Method, and this approach is reflected in the projections contained in Table 14 above. In addition, the City anticipates that the Wastewater System, for fiscal years 2004 and for the foreseeable future, even under the plaintiffs' calculations, will contribute amounts to CERS that will exceed the amounts of the employee contributions. Therefore, under either of the theories espoused at present by the plaintiffs, the Wastewater System will most likely have minimal additional exposure from this litigation.

PART II

2002 FINANCIAL STATEMENTS ERRORS

In September 2003, the City Auditor and Comptroller (the “City Auditor”) and Caporicci & Larson, the outside auditor of the financial statements of the City (the “Outside Auditor”) discovered that certain errors existed in the financial information presented for Fiscal Year 2002 in the audited financial statements of the Metropolitan Wastewater Utility for the Fiscal Years ended June 30, 2002 and 2001 (the “2002 Statements”). The discovered errors were primarily limited to the footnotes to the 2002 Statements. The 2002 Statements present the financial results of the Sewer Revenue Fund. The 2002 Statements were audited by Calderon, Jaham & Osborn (“CJ&O”), to which the Outside Auditor is the successor firm. Upon such discovery, the City Auditor and the Outside Auditor undertook a variety of activities, which continued into December 2003.

The City Auditor’s activities were as follows: (1) confirmed footnote information to supporting sources and source documentation including outside third party sources; (2) compared various footnote disclosures for conformance to generally accepted accounting principles in the United States (“GAAP”); (3) compared footnotes in the 2002 Statements to footnotes in the combined all-funds financial statements to ascertain consistency in numbers or narratives; (4) recalculated the totals of all numerical columns within footnotes; (5) traced and reconciled footnote information to other portions of the 2002 Statements if applicable; and (6) reviewed the footnotes to determine if any could be enhanced for additional clarity in the subsequent year’s financial statements. This process was separately undertaken by each of the Accounting Division and the Audit Division.

The Outside Auditor undertook the following activities: (1) the audit team which audited the 2002 Statements compared the 2002 Statements (including both the financial statements themselves and the footnotes thereto) to the audit working papers that were prepared in connection with the 2002 Statements; (2) the Engagement Partner and the Senior Partner of the Outside Auditor reviewed the 2002 Statements (including both the financial statements themselves and the footnotes thereto) for technical compliance with the requirements of GAAP, which includes relevant Governmental Accounting Standards Board (“GASB”) pronouncements by comparing the 2002 Statements to a technical compliance checklist recommended by the Government Finance Officers Association; (3) the Outside Auditor had a technical Quality Control Review of the 2002 Statements performed by their independent Quality Control Reviewer who is a certified public accountant; and (4) the Outside Auditor met with members of the Accounting Division and the Audit Division of the City Auditor’s Office to compare results of the City Auditor’s and the Outside Auditor’s reviews of the 2002 Statements and assisted the City Auditor in preparing a comprehensive list of the errors in the 2002 Statements. All of the activities of the City Auditor and the Outside Auditor were substantially completed in December 2003.

The review processes undertaken did not constitute a re-audit or re-issuance of either the footnotes or of any other part of the 2002 Statements, and therefore would not necessarily have brought to light any errors that such a re-audit or re-issuance may have uncovered. The review

process of the Outside Auditor included both the financial statements themselves and the footnotes thereto; and the review process of the City Auditor did not extend beyond the footnotes of the 2002 Statements to the actual financial statements, as such, except as indicated above. It is the opinion of the City Auditor and the Outside Auditor that, in accordance with accounting and auditing professional guidelines, discovered errors related primarily to footnotes, and were not material either individually or in the aggregate in the context of the 2002 Statements taken as a whole. Neither the City Auditor nor the Outside Auditor extended this review to any financial statements of the City for years prior to the fiscal year ended June 30, 2002.

Among the errors and correctible statements discovered by the City Auditor and the Outside Auditor in the 2002 Statements were the following:

1. In Note 3 of the Notes to the 2002 Statements (Capital Assets), a Retirement of \$152,839 was incorrectly netted against Additions. This did not affect the actual financial statements, as such.

2. In Note 4 of Notes to the 2002 Financial Statements (Long-Term Debt), miscellaneous errors were found in stated interest rates. This did not affect the actual financial statements, as such.

3. In addition, there were a variety of corrections to Note 6 of the Notes to the 2002 Statements (Pension Plans) (the "Pension Note"). The discussion in this item 3 relates to the City Employees' Retirement System ("CERS") as a whole and reflects pension matters for governmental and business-type funds collectively.

- a. The Pension Note indicated, under subparagraphs b (Funding Policy) and c (Annual Required Contributions) that the City's unfunded actuarially accrued liability ("UAAL") to CERS was being amortized at a percentage of payroll over a period of 30 years with 19 years remaining. In addition, the City reported a net pension obligation ("NPO") as the difference between the actual contributions to the pension plan (pursuant to the 1996 arrangement) and the required amount. The NPO is derived by first amortizing the UAAL over a number of years to establish an annual actuarially required contribution ("ARC"). However, the Pension Note did not indicate that in calculating the ARC the UAAL was being amortized using a running 40-year period, rather than a 30-year fixed period with 19 years remaining. While utilizing such a running 40-year period is permissible under generally accepted accounting principles for reporting an NPO liability it results in an NPO less than would have been reported had the 30 years fixed/19 years remaining amortization method been used. This did not affect the financial statements, as such.

- b. In subparagraph b of the Note (Funding Policy), it was indicated that (1) as a consequence of utilizing the "Corridor" funding method in accordance with the 1996 arrangement, which was not a funding method formally sanctioned by GASB for financial reporting purposes, the City was required to report a liability of \$39.2 million more than had been paid by the City (as an NPO) even though the shortfall was funded in a reserve, and (2) the actuary believed that the Corridor funding method was an excellent method for the City and superior to one of the GASB acceptable methods of funding. The subparagraph did not make

clear that the reserve was, in fact, maintained by CERS, not the City. The reserve was eliminated by CERS during the year ended June 30, 2003, and the elimination of the reserve neither increased nor decreased CERS actuarial assets. While the actuary statements regarding the belief of the actuary and its efforts to obtain an endorsement by the GASB for using such method were correct in 1997, these statements were no longer correct at the time the 2002 Statements were issued. This did not affect the actual financial statements, as such.

Further, while subparagraph b specified the total contributions made during the year, it did not, as required by GAAP relating to accounting for pensions by state and local government employers, show tables of the City's varying contribution rates expressed as percentages of active payroll which range from a low of 8.56% to 52.23% for general members and a low of 18.91% to a high of 21.54% for safety members. This did not affect the actual financial statements, as such.

c. In subparagraph c of the Pension Note (Annual Required Contribution), there were a variety of miscellaneous errors: Among them, the date of June 30, 1996, as the actuarial valuation used to determine the City's annual required contributions should have been June 30, 2001, and the inflation rate assumption should have been 4.25% rather than 4.5% as stated in the subparagraph. This did not affect the actual financial statements, as such.

d. In subparagraph d of the Pension Note (Three-Year Trend Analysis), a column was incorrectly labeled "Actuarially Required Contributions (ARC)" instead of "Annual Pension Cost (APC)," and amounts in that column for the years ended 6/30/00 and 6/30/01 were erroneously stated. The percentage being contributed and the resulting NPO were erroneously stated in those respective columns; the NPO recorded in the table for the year ended 6/30/00, was approximately \$700,000 understated and the amount for the year ended 6/30/01, was approximately \$1.7 million understated. These errors also resulted in the understatement of a category of expenses and a category of liabilities by less than \$100,000 in each of the following financial statements in the 2002 Statements: (1) the Statement of Net Assets, (2) the Statement of Revenues, Expenses, and Changes in Fund Net Assets, and (3) the Statement of Cash Flows.

e. In subparagraph e of the Pension Note (Net Pension Obligation – Three Year Trend Analysis), the same numerical errors as those described in 3.d. above with respect to subparagraph d of the Pension Note were made. In addition, various numerical errors were made in the columns entitled "Interest on NPO," "ARC Adjustment," "APC," "Contributions Made," and "Change in NPO." The numerical errors in the amounts presented under the column NPO (which are the same as those described in 3.d. above with respect to subparagraph d of the Pension Note) resulted in the understatement of a category of expenses and a category of liabilities by less than \$100,000 in each of the following financials statements in the 2002 Statements: (1) the Statement of Net Assets, (2) the Statement of Revenues, Expenses, and Changes in Fund Net Assets, and (3) the Statement of Cash Flows.

f. The Pension Note failed to disclose a table required by GAAP that would have shown the City's analysis of funding progress for the last three Fiscal Years. This did not affect the actual financial statements, as such.

g. A 2002 agreement between CERS and the City relating to, among other things, City pension plan contribution funding requirements, to be effective July 1, 2003, which agreement had been approved before the time of the issuance of the 2002 Statements by both the City and CERS, was not mentioned in the Pension Note as a subsequent event. This agreement superseded the 1996 arrangement referred to in 3.b above. This did not affect the actual financial statements, as such.

h. The Pension Note, under the heading "Defined Contribution Plans", understated the fair value of the assets of the Supplemental Pension Savings Plan as of June 30, 2002 by approximately \$2.3 million. In addition, under the same heading, the Pension Note understated the amount of the employees' contributions for Fiscal Year 2002 to the 401(k) Plan by approximately \$2.3 million and the fair value of the assets of the 401(k) Plan assets as of June 30, 2002 by approximately \$6 million. This did not affect the actual financial statements, as such.

4. In Note 8 of the Notes to the 2002 Statements (Commitments and Contingencies), the amount estimated at the year ended June 30, 2001 for the Wastewater System's contracted construction plans for various projects was understated by approximately \$40.6 million. This did not affect the actual financial statements, as such.

5. In Note 9 of the Notes to the 2002 Statements (Restatement of Beginning Balances) the amount of the restatement is correct for Retained Earnings but, under a GAAP pronouncement, such amount is no longer presented. The restatement should have shown the change to Net Assets instead. This did not affect the actual financial statements, as such.

6. In the Statement of Net Assets at June 30, 2002, certain assets and liabilities were misclassified when compared to GAAP. The total net effect of these misclassifications was that assets were overstated by approximately \$14 million of total assets, and liabilities were overstated by approximately \$14 million of total liabilities. These misclassifications canceled each other out and did not change total net assets, and therefore did not have an impact on the financial statements, as such.

No Reissuance; Future Procedures. The City Auditor and the Outside Auditor are of the opinion that, based upon the activities undertaken by each of them with respect to the 2002 Statements, as described above, and in accordance with accounting and auditing professional guidelines, the errors that were discovered, primarily relating to footnotes, were not material either individually or in the aggregate in the context of the 2002 Statements taken as a whole, and therefore the City Auditor has elected not to reissue 2002 Statements. Further, the Outside Auditor, as the successor to CJ&O, has advised the City Auditor that the City may continue to rely on the CJ&O audit report dated November 27, 2002 related to the 2002 Statements as well as the letter dated the same date from CJ&O to the City Auditor related to the City's internal accounting controls. To the extent that the errors in the 2002 Statements would have had an effect upon the audited financial statements of the Metropolitan Wastewater Utility for the Fiscal Year ended June 30, 2003 (the "2003 Statements"), the necessary corrections were made in the course of the preparation of the 2003 Statements.

As a consequence of the discovery of errors, the City Auditor has implemented the following additional procedures relative to the review process: (1) the establishment and maintenance of a centralized control point and repository for the preparation, review, cross checking of source documentation and source approvals for all footnotes; (2) the requiring of formal consents and approvals by appropriate departments or third parties for all applicable footnotes, and the overall acknowledgment and approval of the obtaining of all such consents and approvals; (3) mandatory cross-checking between separate financial statements and the combined all-funds financial statements; and (4) the reviewing of each of the steps described above by the Audit Division. The Outside Auditor likewise has implemented the following additional audit process procedures with respect to City financial statements: (1) cross-checking of all source documentation provided by the City for reasonableness and appropriateness; (2) requiring written communication by the City for any known material or immaterial errors or misstatements; (3) enhanced documentation of audit progress meetings conducted with key City staff; (4) enhanced communication and cross-checking of information relating to subsequent events, commitments and contingencies and litigation with the offices of the City Auditor and City Attorney; (5) enhanced cross-checking of separate fund and related-entity financial statements to the City's financial statements; (6) a person independent from the audit team for the City will review these financial statements for technical compliance with the requirements of GASB by comparing the financial statements against a technical compliance checklist recommended by the Government Finance Officers Association; and (7) the Director of Accounting and Auditing will review these financial statements for technical compliance with GASB requirements.